

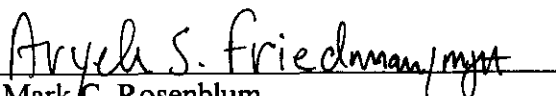
the Commission's statements regarding section 272 are still applicable to the corresponding "replacement" requirements under the *Competitive Carrier Order*.⁵³

CONCLUSION

For the foregoing reasons, the Commission should issue a rule extending section 272 for an additional three years.

Respectfully submitted,

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August 5, 2002

⁵³ The only "partial" rule that should apply in the event the Commission determines to allow all or a part of section 272 to sunset is section 272(e). That is because the Commission in that instance has *no* discretion – Congress explicitly mandated that section 272(e) would *not* sunset. Section 272(e)(1) and section 272(e)(3) apply to both to a BOC and its affiliates, and thus plainly must continue to apply even after any sunset. However, sections 272(e)(2) and (e)(4) apply only to the BOC's affiliates. In response to the request in the *Notice* (§ 20), AT&T agrees that the Commission should re-affirm its conclusion in the *Non-Accounting Safeguards Order* (§ 270) that these subsections, in the case of a sunset, would apply only to the extent a BOC nonetheless maintains an affiliate.

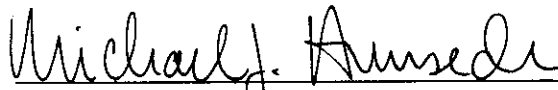
CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of August, 2002, I caused a copy of the foregoing to be served on the following via first class mail, postage pre-paid:

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Room CY-B402
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Michael J. Hunsecker

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

In the Matter of

Section 272(f)(1) Sunset of the
BOC Separate Affiliate and
Related Requirements

WC Docket No. 02-112

Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

August 5, 2002

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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of

Section 272(f)(1) Sunset of the
BOC Separate Affiliate and
Related Requirements

WC Docket No. 02-112

DECLARATION OF LEE L. SELWYN

1 Introduction

2

3 Lee L. Selwyn, of lawful age, declares and says as follows:

4

5 1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc.
6 ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and
7 consulting firm specializing in telecommunications and public utility regulation and public
8 policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part
9 hereof. I have been asked by AT&T to review the *Notice of Proposed Rulemaking*
10 ("NPRM") issued by the Commission in the above-captioned proceeding, to analyze the issues
11 and questions raised therein, and to provide the Commission with specific recommendations
12 thereon.

13

1 2. I have participated in proceedings before the Federal Communications Commission
2 ("FCC" or "Commission") dating back to 1967 and have appeared as an expert witness in
3 hundreds of state proceedings before more than forty state public utility commissions. I have
4 participated in numerous regulatory proceedings involving public utility affiliate relationships
5 and inter-affiliate transactions and transfers. These have included merger proceedings before
6 the California PUC involving Pacific Telesis Group and SBC, and Bell Atlantic and GTE,
7 before the Illinois Commerce Commission involving SBC and Ameritech, before the
8 Connecticut Department of Public Utility Control involving SBC and SNET, and before the
9 Maine PUC involving NYNEX and Bell Atlantic. I also participated in written comments
10 filed with the FCC regarding both the SBC/Ameritech and Bell Atlantic/GTE merger appli-
11 cations. I have participated in a number of Section 271 proceedings, including those in
12 Pennsylvania, New Jersey, California, Minnesota, Delaware and Virginia. I have also
13 submitted testimony before several state commissions addressing proposals for structural
14 separation of ILEC wholesale and retail operations. I participated in proceedings before the
15 California PUC involving Pacific Bell's reorganization of its Information Services (primarily
16 voice mail) business into a separate subsidiary, and the spin-off of Pacific Telesis Group's
17 wireless services business into a separate company. I have participated in a number of
18 matters involving the treatment of transfers of yellow pages publishing from the ILEC to a
19 separate directory publishing affiliate, including the recent case before the Washington
20 Utilities and Transportation Commission addressing imputation of (then) US WEST yellow
21 pages revenues.

22

1 **Summary**
2

3 3. Congress established the requirement for structural separation of the BOC ILEC and
4 long distance entities and the associated transactional and nondiscrimination requirements
5 because it understood that mere satisfaction of the Section 272(c)(2)(B) “competitive
6 checklist” was not by itself sufficient to constrain or otherwise diminish a BOC’s market
7 power with respect to local and access services. Absent appropriate safeguards and the means
8 to enforce them, BOCs have both the capability, as an economic matter, and the strong
9 financial and business incentive, to leverage their local service market power over to the
10 adjacent, and presently highly competitive interLATA long distance market. It is thus
11 critically important that the separate affiliate requirement and its associated safeguards be
12 retained in place until competition for local and access services has developed to the point
13 where that capability is no longer present.

14
15 4. In fact, local and access services competition has not increased significantly in
16 markets where Section 271 approval has been granted, due to the persistence of material
17 economic barriers to entry and discriminatory conduct by the BOCs. Sections 272(b), (c) and
18 (e) all *require* that (with the limited exception of certain activities related to joint marketing
19 of local and long distance services) BOCs afford the same or superior treatment to competing
20 firms with respect to pricing, service availability, service quality, and other terms and
21 conditions, that the BOCs provide to their own long distance business. However, even with
22 the relative transparency provided by Section 272, BOCs have persisted in “pushing the
23 envelope” with respect to their inter-affiliate transactions, resulting in uncompensated transfers

1 of employees, assets and services the effect of which is to force customers of the monopoly
2 ILEC entity to cross-subsidize the BOC's long distance service. Only those antidiscrimination
3 safeguards provided for at Sections 272(e) would survive the separate affiliate sunset. Thus,
4 in addition to creating a number of additional opportunities for discriminatory treatment of
5 rivals, allowing the separate affiliate requirement to sunset would, as a practical matter, make
6 detection of even the remaining antidiscrimination safeguards extremely difficult and in many
7 cases virtually impossible. Extending the sunset will enable the Commission and the public
8 to monitor such misconduct and thereby facilitate remedial measures that would work to
9 curtail it. It is essential that the Section 272 separate affiliate and the associated transactional
10 and nondiscriminatory requirements be retained. Moreover, in view of documented efforts by
11 BOCs to flaunt these statutory obligations and Commission rules, the Commission should
12 adopt additional measures that will help to assure full compliance with applicable law and
13 regulation. If Section 272 is allowed to sunset at this time, there is a substantial risk that
14 competition in both the local and long distance sectors will be rapidly eroded, and that the
15 BOCs will come to dominate and thereby to remonopolize the (currently highly competitive)
16 long distance market as well.
17

Background

5. Structural separation of the BOC and long distance entities is required by Section 272(a) for the first three (3) years following a BOC's receipt of Section 271 authority in a particular state,¹ and may thereafter be extended indefinitely by the FCC. Interactions between the structurally separated BOC and long distance entities with respect to the use or provision of common or shared resources must conform to a set of five conduct provisions set out at Section 272(b) and nondiscrimination requirements set out at Sections 272(c) and 272(e). The Section 272(b) code of conduct requires that the BOC's long distance affiliate:

- (1) shall operate independently from the Bell operating company;
- (2) shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the Bell operating company of which it is an affiliate;
- (3) shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate;
- (4) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and
- (5) shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection.

1. 47 U.S.C. § 272(b). The FCC has specifically characterized these requirements as "structural separation" in *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) (*Non-Accounting Safeguards Order*), at 11 FCC Rcd 21914.

1 The Section 272(c) nondiscrimination provisions require that in its dealings with its long
2 distance affiliate, a BOC:

- 3
4 (1) may not discriminate between that company or affiliate and any other entity in the
5 provision or procurement of goods, services, facilities, and information, or in the
6 establishment of standards; and
7
8 (2) shall account for all transactions with an affiliate described in subsection (a) in
9 accordance with accounting principles designated or approved by the Commission.
10

11 Section 272(e) requires that a BOC and its long distance affiliate:

- 12
13 (1) shall fulfill any requests from an unaffiliated entity for telephone exchange service
14 and exchange access within a period no longer than the period in which it provides
15 such telephone exchange service and exchange access to itself or to its affiliates;
16
17 (2) shall not provide any facilities, services, or information concerning its provision of
18 exchange access to the affiliate described in subsection (a) unless such facilities,
19 services, or information are made available to other providers of interLATA services
20 in that market on the same terms and conditions;
21
22 (3) shall charge the affiliate described in subsection (a), or impute to itself (if using the
23 access for its provision of its own services), an amount for access to its telephone
24 exchange service and exchange access that is no less than the amount charged to any
25 unaffiliated interexchange carriers for such service; and
26
27 (4) may provide any interLATA or intraLATA facilities or services to its interLATA
28 affiliate if such services or facilities are made available to all carriers at the same
29 rates and on the same terms and conditions, and so long as the costs are
30 appropriately allocated.
31

1 Based upon the various Verizon and SBC Section 272(b)(5) affiliate transaction postings and
2 service offers provided on the companies' websites² and the first Verizon Section 272 Audit
3 report for New York,³ it has become apparent that the various interactions between the BOCs
4 and their respective 272 long distance affiliates raise serious questions as to the actual, *de*
5 *facto* extent of "separation" that prevails in practice as between the two supposedly separate
6 corporate units. A significant portion, although by no means all, of these interactions relate
7 in some manner to activities associated with the "joint marketing," joint account administra-
8 tion, and combined billing of the BOCs' local and long distance services. Each of these
9 activities is being undertaken by the BOC and its affiliate as if, for all practical purposes,
10 Section 272 did not exist.

11

12 6. The purpose of the Section 272(a) separate affiliate requirement, the Section 272(b)
13 code of conduct, and the Section 272(c) and 272(e) nondiscrimination requirements was *and*
14 *is* to forestall the potential for discriminatory and anticompetitive conduct arising out of the
15 ability, as an *economic* matter, of the BOC to extend its market power in the *local*
16 telecommunications market into the adjacent long distance market.⁴ The Commission has

17 2. <http://www.verizonld.com/regnotices/index.cfm?OrgID=1>;
18 http://www.sbc.com/public_affairs/regulatory_documents/affiliate_agreements/0,5931,199,00.html

19 3. *In the Matter of Implementation of the Telecommunications Act of 1996: Accounting*
20 *Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Reports of
21 Independent Accountants on Applying Agreed-Upon Procedures, prepared by Pricewater-
22 houseCoopers LLP, filed June 11, 2001 and June 18, 2001. ("New York 272 Audit Report")

23 4. *Conference Report on S. 652, Telecommunications Act of 1996* (House of
24 Representatives- February 01,1996), *Congressional Record*, H1171.

1 previously noted that Section 272 contains all of the necessary elements to constrain BOC
2 exercise of this market power;⁵ however, empirical evidence from states with Section 271
3 approval indicates that, as currently applied, Section 272 is not by itself sufficient prevent
4 discrimination and anticompetitive behavior by the BOC for the benefit of its long distance
5 affiliate.

6
7 7. Accordingly, for so long as the BOC ILEC entity continues to possess market power,
8 the Commission should extend the requirement that BOCs operate their interLATA business
9 activities through structurally separate affiliates as required by Section 272. Additionally,
10 however, the Commission must ensure that BOCs do not continue to undertake merely super-
11 ficial measures to comply with the separations requirements. Unless Section 272 is complied
12 with in the manner intended by Congress and this Commission, consumers and competitors
13 will have no protection against anticompetitive conduct on the part of the incumbent BOCs.
14

15 5. *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services*
16 *Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the*
17 *Interstate, Interexchange Marketplace*, CC Docket No. 96-149, 96-61, *Opinion*, Rel. April 18,
18 1997 ("LEC Interexchange Non-Dominant Order"), 12 FCC Rcd 15756, at 15763.

1 **Attainment by a BOC of Section 271 in-region interLATA authority cannot be construed**
2 **as demonstrating or implying that the BOC no longer has market power or that the**
3 **local service market in the state in which such authority has been granted has become**
4 **competitive.**
5

6 8. The instant consideration of either extending the separate affiliate and nondiscrimin-
7 ation requirements of Sections 272(a), (b) and (c) and/or of putting in place “any alternative
8 safeguards ... in states where the statutory requirements have sunset”⁶ must be made in the
9 context of the history and background that gave rise to the separate affiliate requirement in
10 the 1996 federal legislation. That history begins with the U.S. Department of Justice’s
11 (“DoJ”) 1974 antitrust case against the pre-divestiture Bell System⁷ in which the DoJ alleged,
12 *inter alia*, that the Bell companies were using their local service monopoly to prevent
13 competition in the adjacent long distance market. The *Modification of Final Judgment*
14 (“MFJ”), the 1982 Consent Decree under which the former Bell System was broken up and
15 the Bell Operating Companies (“BOCs”) were divested from AT&T,⁸ prohibited the divested
16 BOCs from offering interLATA long distance services. This *structural remedy* was adopted
17 specifically to prevent the BOC local service monopolies from using their monopoly market
18 power in the local services market to block competition in the adjacent long distance market.

19 6. *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related*
20 *Requirements*, WC Docket No. 02-112, *Notice of Proposed Rulemaking*, Rel. May 24, 2002
21 (“NPRM”), at para. 1.

22 7. *United States v. Western Electric Company, Inc., et al*, Civil Action No. 74-1698
23 (D.D.C.).

24 8. *U.S. v. Western Electric Co. et al.*, 552 F. Supp. 131 (D. D.C., 1982), *aff’d sub nom.*
25 *Maryland vs. U.S.*, 460 U.S. 1007 (1983); and *Modification of Final Judgment*, sec. VIII.B.

1 And because the BOCs were themselves precluded from providing long distance services,
2 they were made to be *indifferent* as to which long distance carrier their customers might
3 individually select. Section 271 of the federal *Telecommunications Act of 1996* ("Act" or
4 "1996 Act") replaced the MFJ long distance "line of business" restriction with a process by
5 which BOCs could enter the "in-region" long distance market, provided that they
6 implemented a series of specific measures that, in principle, would have the effect of
7 irreversibly opening their previously monopolized local telecommunications markets to
8 competitive entry.⁹ To the extent that the *local* market itself becomes competitive, the
9 BOCs' ability to exert market power in the adjacent long distance market could be attenuated.
10 Conversely, when a BOC such as Verizon or SBC is allowed to offer in-region long distance
11 service in a less-than-fully-competitive local market, then the BOC acquires both the ability
12 and the incentive to engage in precisely the same type of anticompetitive conduct that the
13 *MFJ* was intended to prevent. In principle, this was also the purpose of Section 271.

14

15 9. Section 271(c) of the 1996 *Act* sets forth the specific requirements that a BOC must
16 satisfy in order to obtain authority to provide in-region interLATA services. The BOC must,
17 if applying under "Track A," demonstrate that it has entered into at least one (1) inter-
18 connection agreement with a competing local service provider providing service (other than
19 by resale of the ILEC's services) to residential customers and to business customers, although

20 9. See, e.g., *In the Matter of the Application by Bell Atlantic New York for Authorization*
21 *Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in*
22 *the State of New York*, CC Docket No. 99-295, *Memorandum Opinion and Order*, 15 FCC
23 Rcd 3953, 4164 ("Bell Atlantic New York Order").

1 the existence of one agreement with a single carrier providing service to both groups would
2 be sufficient (Section 272(c)(1)(A)). The BOC must also satisfy a “checklist” of fourteen
3 “specific interconnection requirements” that, for the most part, are reiterations of obligations
4 that are imposed by Section 251 upon *all ILECs* separate and apart from any long distance
5 entry *quid pro quo*.

6
7 10. As interpreted by the FCC, Section 271 does not require a BOC to demonstrate that
8 actual entry has occurred, that competing services are available generally throughout the state
9 in question, or that the incumbent BOC has suffered or sustained any diminution of its
10 preexisting market power.¹⁰ In fact, the FCC has on several occasions *rejected* arguments,
11 advanced by competing IXC's and others, that a BOC's continued dominance and pervasive
12 control of the local market would make approval of its in-region interLATA entry contrary to
13 the public interest notwithstanding its apparent satisfaction of the “competitive checklist.”¹¹

14
15 11. Inasmuch as the threshold conditions for the FCC's grant of in-region interLATA
16 authority do not require the BOC to demonstrate, or the FCC to find, that *effective competi-*

17 10. If the BOC is applying for Section 271 authority under “Track A” (i.e., Section
18 271(c)(1)(A)), it is only required to demonstrate that there is a minimum of just “one
19 competing carrier” offering service to residential and to business customers in the state
20 utilizing either the CLEC's own facilities or UNEs leased from the BOC. *In the Matter of*
21 *Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of*
22 *1934, as amended, To Provide In-Region, InterLATA services In Michigan*, CC Docket No.
23 97-137, *Memorandum Opinion and Order*, Rel. August 19, 1997, 12 FCC Rcd 20543, 20598.

24 11. See, e.g., *Bell Atlantic New York Order*, 15 FCC Rcd 4163.

1 *tion* has developed or that the BOC no longer has market power in the local service market in
2 a given state, the fact that a BOC has obtained Section 271 in-region interLATA authority
3 cannot be construed as implying that it no longer has market power or that the local service
4 market in the state in which such authority has been granted — and particularly in all parts of
5 that state — has become competitive. Indeed, in establishing the Section 272(a) and (b)
6 separate affiliate requirements and the Section 272(c) and 272(e) nondiscrimination require-
7 ments, Congress clearly sought to dissociate a BOC's satisfaction of Section 271(c) with any
8 finding or determination that it no longer had market power. On the other hand, Congress
9 also understood that *if* the development of actual and effective competition in the local market
10 were to occur, then the BOC's market power could be diminished or perhaps even eliminated.
11 But Congress had no illusions about that taking place immediately upon enactment of the
12 1996 law, immediately upon a BOC's receipt of Section 271 authority in a given state or, for
13 that matter, even after a finite and predetermined interval of time following such grant.
14 Specifically:

15

16 • Congress established an explicit "separate affiliate" requirement (Section 272(a)) that
17 would be *mandatory* for *at least* three years following a BOC's long distance entry
18 in a given state;

19

20 • Tolling of that three-year clock commences not as of the date of enactment of the
21 1996 law, but as of the date upon which the BOC's Section 271 authority becomes
22 effective, separately for each state for which such approval is obtained; and

- 1 • The FCC is empowered to extend the separate affiliate requirement beyond the initial
2 three-year “sunset” period “by rule or order” and, based upon the Commission’s
3 determination in the instant *Notice*, may modify or adopt new rules pertaining to
4 such affiliate relationship as part of or in lieu of such an extension.¹²

5

6 Elimination of the separate affiliate requirement at a time when the BOC still maintains
7 extensive market dominance and market power would be inconsistent with, and would
8 therefore frustrate, the specific policy goals underlying Section 272.

9

10 12. That the tolling of the three-year “sunset” period for Section 272(a) commences only
11 as of the date that the BOC obtains Section 271 authority, rather than as of the date of
12 enactment of the 1996 law (February 8, 1996) or the date at which the FCC promulgated
13 rules addressing the specific obligations applicable to ILECs for dealing with CLECs (August
14 8, 1996), further demonstrates Congress’ understanding that the mere establishment of formal
15 legal requirements does not by itself assure that they will be effective in achieving the legis-
16 lation’s goals. To the extent that *noncompliance* by the BOCs would work to extend their
17 legacy monopoly and forestall revenue erosion, BOCs continue to have strong financial and
18 business incentives to move as slowly as possible to open their networks to competition.¹³

19 12. *NPRM*, at para. 1.

20 13. SBC’s Vice President for marketing, J. David Gallemore, was quoted in a 1995
21 *Business Week* interview as stating that “[w]e are at a critical juncture,” and “*we want to*
22 *make our welcome mat [for competitors] smaller than anyone else’s.*” “Pick of the Litter:
23 Why SBC is the Baby Bell to Beat,” *Business Week*, March 6, 1995 (emphasis supplied).

1 Congress understood and recognized that it could not *legislate* a competitive market into
2 existence; what it could do is to enact laws that would, if fully complied with, make
3 competition *possible* both as an economic and as a legal matter, and to adopt measures
4 designed to *encourage* the BOCs to take steps that are in other respects at odds with their
5 business and financial interests. Each and all of the “fourteen points” contained in the
6 Section 271(c)(2)(B) “competitive checklist” appear elsewhere in the statute as obligations
7 imposed upon *all* incumbent local exchange carriers *separate and apart from the matter of*
8 *long distance entry* (see Table 1 below). Viewed in that context, Section 271(c)(2)(B) is thus
9 *entirely redundant* at least insofar as specifying the things that BOCs (as ILECs) are required
10 to do to accommodate CLEC entry; its sole purpose was to offer the BOCs a “reward” that
11 perhaps would overcome their otherwise natural incentive to resist compliance to the greatest
12 possible extent. However, once the “checklist” has been “satisfied” and in-region entry has
13 been achieved, the compliance “carrot” will no longer be there, and those same business and
14 financial incentives will once again dominate BOC conduct.¹⁴ In expressly authorizing the
15 FCC to extend the sunset date for the Section 272 separate affiliate requirement, Congress
16 well understood that there is simply no basis to assume or to expect that merely as a result of

17 14. The FCC is cognizant of this “backsliding” potential, and has adopted measures
18 designed to overcome it. *Bell Atlantic New York Order*, 15 FCC Rcd 4174-4177. At bottom,
19 however, the entry “carrot” and the backsliding “stick” are in no sense symmetric because, as
20 a practical matter, it will be far more difficult to *rescind* a BOC’s in-region long distance
21 authority in the event of post-approval noncompliance than it had been to grant it as a reward
22 for (pre-approval) compliance.

Table 1 BOC Compliance with all of the Sec. 271(c)(2)(B) "checklist" items is Mandatory Even if the BOC Does Not Seek In-Region InterLATA Authority		
Checklist	Compliance requirement	Also Found At
1	Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1).	251(c)(2); 252(d)(1)
2	Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).	251(c)(3); 252(d)(1)
3	Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224.	251(b); 224
4	Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services.	251(c)(3)
5	Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.	251(c)(3)
6	Local switching unbundled from transport, local loop transmission, or other services.	251(c)(3)
7	Nondiscriminatory access to ((i) 911 and E911 services; (ii) directory assistance services to allow the other carrier's customers to obtain telephone numbers; and (iii) operator call completion services.	251(b)(3); 251(c)(3)
8	White pages directory listings for customers of the other carrier's telephone exchange service.	251(b)(3)
9	Compliance with guidelines, plan or rules established by numbering plan administrator.	251(e)
10	Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.	251(a); 251(c)(3); 251(c)(5)
11	Compliance with FCC regulations regarding number portability.	251(b)(2)
12	Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).	251(b)(3)
13	Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).	252(d)(2)
14	Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).	251(c)(4) and 252(d)(3)

1 the passage of time (i.e., three years), the BOCs' market power would have diminished to the
2 point where that separate affiliate and associated nondiscrimination requirements are no longer
3 necessary.

4
5 13. What Congress has done is to create a transition between the outright prohibition of
6 long distance entry that had prevailed under the MFJ, to unfettered BOC participation in
7 in-region long distance, using a transitional separate affiliate mechanism that could be
8 extended by the FCC beyond the minimum three-year period.¹⁵ This transitional mechanism
9 provides important safeguards against BOC anticompetitive conduct that had been
10 unnecessary under the pre-1996 MFJ "line-of-business" outright prohibition against long
11 distance entry. The Section 272(a) and (b) separate affiliate requirements and 272(c) and (e)
12 nondiscrimination requirements serve two separate objectives:

13
14 (1) By requiring that the long distance affiliate "operate independently" vis-a-vis the
15 BOC ILEC entity and by expressly prohibiting "discriminat[ion] between that
16 company or affiliate and any other entity in the provision or procurement of goods,
17 services, facilities, and information, or in the establishment of standards," the BOC is
18 limited as to the extent to which it can confer any unique competitive advantage,
19 arising from its incumbency and certain potential economies of network integration,
20 upon its affiliate long distance entity, to the detriment of nonaffiliated IXCs; and
21

22 15. 47 U.S.C. § 272(f)(1).

1 (2) By requiring that the details of inter-affiliate transactions and transfers of assets and
2 services be made at fair market value, posted on the BOC's website, and ultimately
3 subject to periodic audit, BOC conduct that is inconsistent with the statute is made
4 more easily detectible than it would be if the BOC were permitted to conduct its
5 largely monopolistic local and competitive long distance businesses on a fully
6 integrated basis.

7
8 The Congressional purpose for the separate affiliate requirement is not served if all that the
9 requirement entails are nominal bureaucratic constructs easily "satisfied" by the BOC and its
10 272 affiliate by merely maintaining facial separation.¹⁶ Yet on the basis of the affiliate
11 agreements entered into by Verizon and SBC and their 272 Affiliates, the pricing plans
12 offered by Verizon Long Distance and SBCS, as well as the reported results of the first
13 Verizon New York 272 audit, it is now evident that these two BOCs seek to interpret and to
14 apply the separate affiliate requirement in precisely that superficial a manner and, wherever

15 16. In Section 271 proceedings before state commissions, BOCs have made a special effort
16 to deflect attention away from any of the Section 272 requirements. For example, Dr.
17 William E. Taylor, testifying for Qwest in Minnesota, has actually claimed that "the Act does
18 not impose complete structural separation between a BOC and its 272 affiliate. Indeed, its
19 central requirement that transactions between the two be posted and made available to other
20 carriers is based on the assumption that the two will share services, that such sharing reflects
21 economies and efficiencies that should be permitted, and that the way to prevent any
22 anticompetitive behavior is to make those terms and conditions available to the competitors of
23 the 272 affiliate." Minnesota PUC Docket No. P-421/C1-01-1372, OAH Docket No. 7-2500-
24 14487-2, Affidavit of Dr. William E. Taylor, December 28, 2001, at para 7. At the very
25 least, it would appear that Dr. Taylor shares my view as to the importance of retaining the
26 separate affiliate and associated conduct and nondiscrimination requirements beyond the three-
27 year sunset date.

possible, to conduct their business transactions and relationships *as if the separate affiliate requirement did not exist*. Elimination of the separate affiliate requirement and with it the lens of public scrutiny of BOC inter-affiliate transactions will make conduct such as misallocation of costs and the resulting creation of cross-subsidies virtually undetectable, affording the BOCs opportunity and incentive to expand the scope of such anticompetitive behavior going forward.

BOCs retain market power in the local market and retain the ability to cross-subsidize their long distance services and to otherwise discriminate against nonaffiliated IXC.

14. The FCC has defined market power as, *inter alia*, “the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable.”¹⁷ In a competitive, multi-firm market, consumers are able to shift their purchases easily among the various suppliers in response to any unilateral action by any individual firm to raise its price above the competitive market level. Under these conditions, consumers can be expected to respond to a price increase initiated by any one firm by rapidly shifting their business to another provider whose prices have remained stable. As a result, the attempt by the first firm “to raise and maintain price above the competitive level” will not be successful, and could not be sustained. While BOCs have repeatedly claimed that they

17. *Competitive Carrier Fourth Report and Order*, 95 FCC 2d at 558, at para. 8 (citing *inter alia* W.M. Landes & R.A. Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 937 (1981), and A. Kahn, *The Economics of Regulation* 65-66 (1970)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as “the ability profitability to maintain prices above competitive levels for a significant period of time.” 1992 Merger Guidelines, at 20,570.

1 confront competition in the local telephone service market — and have sought to support
2 those contentions with “head counts” of purported “competitors” — at bottom there has never
3 been any demonstration that BOCs are *not* able “to raise and maintain price above the
4 competitive level without driving away so many customers as to make the increase
5 unprofitable.” To the contrary, while feigning competitive pressures, BOCs have frequently
6 *raised their prices* when given the “pricing flexibility” to do so, and have almost never
7 responded to CLEC pricing initiatives by dropping their rates in areas in which CLECs have
8 achieved some actual presence. Hence, there is no basis for the Commission to find that
9 there has been *any* consequential diminution of BOC market power in the local services
10 market since the date of enactment of the 1996 law.

11

12 15. The requirements that a market is *open* to competition, the standard applied by the
13 FCC when considering BOC section 271 applications, teaches nothing about the BOC's reten-
14 tion of market power in that local market. Without viable, readily available customer choice
15 among local service providers, no theoretical ability of a competitor to enter the market will
16 meaningfully restrict a BOC's incentive or ability to raise local prices above competitive
17 levels. Indeed, this Commission specifically anticipated that a BOC would retain and be able
18 to exercise local market power even after grant of authority to provide in-region interLATA
19 services:

20

21 Although we are classifying these carriers as non-dominant with respect to their
22 provision of in-region and out-of-region long distance services, as summarized
23 above, we recognize that, *as long as these carriers retain market power in*
24 *providing local exchange and exchange access services, they will have some*

1 *incentive and ability to misallocate costs to local exchange and exchange access*
2 *services, to discriminate against their long distance competitors, and to engage*
3 *in other anticompetitive conduct.*¹⁸
4

5 To the best of my knowledge, the Commission has *never* determined, with respect to any of
6 its Section 271 rulings, that the BOC under inquiry no longer had market power or would be
7 incapable of “misallocat[ing] costs to local exchange and exchange access services, [of]
8 discriminat[ing] against their long distance competitors, and [of] engag[ing] in other
9 anticompetitive conduct.”
10

11 16. The Commission's chosen solution to the potential for anticompetitive conduct
12 stemming from BOC market power was, *inter alia*, the application of Section 272:

13 In light of the requirements established by, and pursuant to, sections 271 and
14 272, together with other existing Commission rules, we conclude that the BOCs
15 will not be able to use, or leverage, their market power in the local exchange or
16 exchange access markets to such an extent that their section 272 interLATA
17 affiliates could profitably raise and sustain prices of in-region, interstate,
18 domestic, interLATA services significantly above competitive levels by
19 restricting the affiliate's own output.¹⁹
20
21

22 This linkage between “sections 271 and 272, together with other existing Commission rules”
23 and the BOCs' ability “to use, or leverage, their market power in the local exchange or
24 exchange access markets to such an extent that their section 272 interLATA affiliates could
25 profitably raise and sustain prices of in-region, interstate, domestic, interLATA services

26 18. *LEC Interexchange Non-Dominant Order*, 15764-15765, emphasis supplied.

27 19. *Id.* at 15763.

1 significantly above competitive levels by restricting the affiliate's own output" is no less valid
2 today and for the foreseeable future than it was in 1997 when this determination was made.
3 Put differently, were the Commission to permit the Section 272 separate affiliate requirement
4 and its associated 272(b) code of conduct to expire, there is little doubt that the BOCs *would*
5 "be able to use, or leverage, their market power in the local exchange or exchange access
6 markets to such an extent that their section 272 interLATA affiliates could profitably raise
7 and sustain prices of in-region, interstate, domestic, interLATA services significantly above
8 competitive levels by restricting the affiliate's own output."

9

10 17. The BOCs' local market power has not diminished since 1997. When considering
11 the bundling of services in March 2001, the Commission again found that BOCs retain market
12 power in the local exchange market, and again based its policy upon the conclusion that
13 Section 272 provided a check on the ability of a BOC to leverage its local market power into
14 adjacent markets:

15

16

17 Despite the inroads made by competitors into the local exchange market that we
18 described above, incumbent LECs retain market power in the provision of local
19 service within their respective territories. Thus, unlike our previous analysis of
20 the interexchange market or nondominant LECs, incumbent LECs possess one of
21 the essential characteristics for engaging in anticompetitive behavior — market
22 power with respect to one of the components in the bundle. Nonetheless, we
23 conclude, in light of the existing circumstances in these markets, that the risk of
24 anticompetitive behavior by the incumbent LECs in bundling CPE and local
25 exchange service is low and is outweighed by the consumer benefits of allowing
26 such bundling. We view the risk as low not only because of the economic
difficulty that even dominant carriers face in attempting to link forcibly the

1 purchase of one component to another, *but also because of the safeguards that*
2 *currently exist to protect against this behavior.*²⁰

3
4 18. As recently as July 15 of this year, FCC Chairman Michael Powell was quoted in
5 *The Wall Street Journal* reiterating the conclusion that BOCs have been slow to lose their
6 market power in the local market: "We correctly believed these markets didn't need to be
7 natural monopolies and they could be competitive, but I think we tended to over-exaggerate
8 how quickly and how dramatically it could become competitive."²¹

9
10 19. The FCC is not alone in remaining concerned about BOC local market power and its
11 potential anticompetitive effects. The New York PSC has recently found that Verizon New
12 York remains dominant in the special services (i.e. UNEs and special access) market:

13
14 Verizon's data, as well as the advantages attendant upon its historical incumbent
15 position, indicate it continues to occupy the dominant position in the Special
16 Services market, and by its dominance is a controlling factor in the market.
17 Because competitors rely on Verizon's facilities, particularly its local loops,
18 Verizon represents a bottleneck to the development of a healthy, competitive
19 market for Special Services. In this situation, regulation is needed to assure the
20 development of competitive choices, and good service quality when choices are
21 not available. Accordingly, we find that a competitive facilities-based market for

22 20. *In the Matter of Policy and Rules Concerning the Interstate, Interexchange*
23 *Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as*
24 *amended*; CC Docket No. 96-61; 1998 Biennial Regulatory Review — Review of Customer
25 *Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange,*
26 *Exchange Access And Local Exchange Markets*, CC Docket No. 98-183, Report and Order,
27 Rel. March 30, 2001, 16 FCC Rcd 7418, 7438, emphasis supplied. At 16 FCC Rcd 7434, the
28 Commission specifically notes Section 272, *inter alia*, as providing sufficient protection
29 against the market power of the BOCs.

30 21. "FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom," *The Wall*
31 *Street Journal*, July 15, 2002, at A1, A4.

1 Special Services has yet to emerge and that Verizon continues to dominate the
2 market overall.²²
3

4 CLECs and IXC's depend heavily upon BOC special services in order to furnish retail local
5 and long distance services to their own customers. By virtue of their control over these
6 bottleneck facilities, BOCs are in a position to restrict the availability of these essential
7 services to their rivals. If the special services market were competitive, the creation of
8 artificial limitations on service availability would not be possible.
9

10 20. In a Draft Decision released July 23, 2002 in the current Pacific Bell Section 271
11 consultative proceeding in California, the presiding Administrative Law Judge, while on the
12 one hand finding that Pacific Bell had satisfied 12 out of the 14 checklist items and on that
13 basis recommending that the California Commission so advise the FCC, nevertheless observed
14 that:

15 Local telephone competition in California exists in the technical and quantitative
16 data; but it has yet to find its way into the residences of the majority of
17 California's ratepayers. Only time and regulatory vigilance will determine if it
18 ever arrives. We expect that the public interest will be positively served in
19 California by the addition of another experienced, formidable competitor in the
20 intrastate interexchange market. At the same time, we foresee the harm to the
21 public interest if actual competition in California maintains its current anemic
22

23 22. *Proceeding on Motion of the Commission to Investigate Methods to Improve and*
24 *Maintain High Quality Special Services Performance by Verizon New York Inc.*, Case 00-C-
25 2051, *Proceeding on Motion of the Commission to Investigate Performance-Based Incentive*
26 *Regulatory Plans for New York Telephone Company*, Case 92-C-0665, before the New York
27 Public Service Commission, *Opinion and Order Modifying Special Services Guidelines for*
28 *Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*,
29 June 15, 2001, at 9.

1 pace, and Pacific gains intrastate long distance dominance to match its local
2 influence.²³
3

4 Other state commissions have similarly found that ILECs retain substantial market power with
5 respect to local and access services. The Indiana Utility Regulatory Commission recently
6 concluded:

7
8 However, we cannot ignore the potential negative consequences or anti-competi-
9 tive effects that could flow from an unrestricted grant of authority to an affiliate
10 of the largest ILEC in Indiana. The conditions that are ordinarily imposed on
11 facilities-based carriers are only a starting point as those conditions were
12 designed primarily for CLECs. This docket involves certification of an affiliate
13 of the largest ILEC in the state. This Cause also involves an affiliate intending
14 to use advanced technology and investment in the public network for the
15 provision of advanced services. Ameritech Indiana as the dominant local
16 exchange provider has the incentive and capability to exercise market power.²⁴
17

18 The Montana PUC echoed Indiana's concern:

19
20 The Commission is sympathetic to the concerns expressed by the parties and
21 recognizes that the competitive local exchange market will likely create
22 opportunities for customers to obtain services from alternate providers even
23 though they may have delinquent accounts with a competitor. This will be a
24 change for the incumbent LEC which has been the only provider of telecom-

25 23. Calif. PUC, *Draft ALJ Decision Granting Pacific Bell Telephone Company's Renewed*
26 *Motion for an Order that it has Substantially Satisfied the Requirements of the 14-point*
27 *Checklist in § 271 of the Telecommunications Act of 1996 and Denying that it has Satisfied §*
28 *709.2 Of the Public Utilities Code, R.93-04-003 et seq.*, released July 23, 2002 ("California
29 *PUC Draft 271 Decision*").

30 24. *In the Matter of the Petition of Ameritech Advanced Data Services of Indiana, Inc.*
31 *(Which Is In the Process of Adopting the Business Name of SBC Advanced Solutions, Inc.)*
32 *For A Certificate of Territorial Authority to Provide Facilities-based and Resold*
33 *Telecommunications Services Throughout the State of Indiana and Requesting the Commission*
34 *to Decline to Exercise Jurisdiction Pursuant to I.C. 8-1-2.6*, Indiana Utility Regulatory
35 Commission Cause No. 41660, *Opinion*, 2001 Ind. PUC LEXIS 275, approved May 19, 2001,
36 at *39-*40.

1 munications service in the past and which still has near total market power,
2 particularly in rural states like Montana.²⁵

3
4 21. Raw data purporting to quantify the extent of CLEC market penetration that has
5 been offered by BOCs in various Section 271 proceedings is, at a minimum, highly
6 controversial²⁶ and, consistent with the California ALJ's finding, does not establish that
7 competition exists "on the ground" at a level that offers consumers a realistic alternative to
8 the BOC's services or that works to limit or constrain the BOC's market power.

9
10 22. The FCC Industry Analysis and Technology Division's latest figures for local
11 competition also belie any claims by BOCs that they have lost market power. As of
12 December 2001, CLECs nationally had only a 10% local market share, and some 38% of US
13 zip codes lacked even a single competitive local provider.²⁷ Despite BOC claims that their

14 25. *In the Matter of the Application of Citizens Telecommunications Company of Montana*
15 *and CommSouth Companies, Inc., Pursuant to Section 252(e) of the Telecommunications Act*
16 *of 1996 for Approval of Their Resale Agreement*, Montana Public Service Commission, Utility
17 Division Docket No. D2000.7.104; Order No. 6281, *Final Order*, Montana Public Service
18 Commission, 2000 Mont. PUC LEXIS 121, October 16, 2000, at 13.

19 26. In seeking to quantify the extent of CLEC market presence, BOCs have relied upon
20 CLEC E911 database entries adjusted to exclude UNE-Loops, as indicative of the number of
21 CLEC facilities-based lines. But E911 database records are keyed to *telephone numbers*, not
22 telephone *lines*, and in the case of multiline business customers the quantity of individual
23 telephone numbers may be a multiple of the number of individual lines. In addition, BOCs
24 have typically not excluded from the E911 "number counts" non-UNE BOC facilities that are
25 being leased to CLECs such as and including Special Access lines. In fact, since CLECs are
26 frequently unable to utilize UNE-loops to serve multiline business customers, the quantity of
27 BOC Special Access facilities being leased by CLECs likely represents a substantial fraction
28 — possibly even the *majority* — of CLEC-provided retail lines.

29 27. FCC Industry Analysis and Technology Division, *Local Telephone Competition: Status*
30 *as of December 2001*, Rel. July 23, 2002, ("*Local Competition Report*"), at Tables 6 and 14.

1 entry into the interLATA market is the catalyst that will stimulate CLEC entry, the “facts on
2 the ground” do not come even remotely close to supporting that contention. For one thing,
3 even for those states in which CLEC retail penetration is highest, the penetration of *facilities-*
4 *based* competitive services is minimal. According to FCC data, for the sixteen states in
5 which in-region long distance entry has been permitted (which include fourteen BOC states
6 that have attained Section 271 authority plus Connecticut and Hawaii, where no such
7 authority was required), BOCs (and, in the case of Connecticut and Hawaii, non-BOC ILECs)
8 provide the underlying facilities for roughly 97.4% of all residential lines (see Table 2).

9
10 23. New York, the most frequently cited example of “robust” local competition, is still
11 struggling with BOC local market power. A report including an analysis of local competition
12 presented recently by the staff of the New York Public Service Commission (NYPSC)
13 indicates that CLEC penetration rates in New York actually *decreased* in the second quarter
14 of 2001, suggesting that the initial CLEC gains following Verizon's interLATA entry could
15 not be sustained.²⁸ The NYPSC staff attributes this drop to poor performance in the CLEC
16 capital market, to UNE pricing problems, and to a myriad of small obstacles placed by
17 Verizon on CLEC competitors attempting to interconnect or secure facilities from the
18 BOC.²⁹ The NYPSC recently issued an order significantly reducing UNE rates,³⁰ and it is
19 my understanding that CLEC activity has increased as a result. And that is the point: CLECs

20 28. New York Public Service Commission, *In the Matter of Verizon— New York*, Case No.
21 00– C– 1945, Report of Commission Staff, February 2002, at 18-19.

22 29. *Id.*

23 30. *Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and*
24 *to Investigate the Future Regulatory Framework*, NYPSC Case 00-C-1945, *Proceeding on*
25 *Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled*
26 *Network Elements*, NYPSC Case 98-C-1357, *Order Instituting Verizon Incentive Plan*, New
27 York Public Service Commission, February 27, 2002.

Table 2

CLEC Facilities-Based Residential Penetration for States with BOC or ILEC In-Region InterLATA Authority			
State	CLEC Residential Retail Market Share	Percent of CLEC Lines that are Facilities- based	CLEC Residential Facilities- based Market Share
Connecticut	3.87%	48.73%	1.88%
Hawaii	0.00%	0.00%	0.00%
New York	22.48%	20.33%	4.57%
Texas	11.27%	19.13%	2.16%
Kansas	7.02%	17.00%	1.19%
Oklahoma	4.28%	55.66%	2.38%
Massachusetts	10.59%	47.44%	5.02%
Pennsylvania	9.93%	43.15%	4.28%
Arkansas	0.00%	0.00%	0.00%
Missouri	3.84%	14.03%	0.54%
Rhode Island	13.48%	56.93%	7.68%
Vermont*	0.23%	0.00%	0.00%
Georgia	7.62%	27.91%	2.13%
Louisiana	0.52%	23.09%	0.12%
Maine	0.00%	0.00%	0.00%
New Jersey	1.55%	21.50%	0.33%
Weighted Average	9.87%		2.59%
<p>Source: FCC, Wireline competition Bureau, Industry Analysis and Technology Division, <i>Local Competition Report</i>, Rel. July 23, 2002, at Tables 6, 8, and 9. Averages are weighted by total residential lines. States designated by IATD with CLEC penetration levels too small to maintain firm confidentiality are included as 0%. Facilities-based percentage is for total CLEC lines, however, since CLECs more commonly serve residential lines via UNE or resale arrangements, the CLEC facilities-based residential share figures likely overstate actual CLEC facilities-based residential shares. Data for Vermont is taken from Application by Verizon New England, Inc., et al, for Authorization To Provide In-Region, InterLata Services in Vermont, WC Docket No. 02-7, Verizon Brief, filed January 17, 2002, at 7</p>			

1 will attempt to enter and compete in the local market when they can do so profitably, not
2 because the ILEC is or is not in the long distance business.

3
4 24. In fact, any CLEC competition that does exist is holding on by a thread. Last
5 August (2001), CLEC analysts at Morgan Stanley Dean Witter noted that the market
6 capitalization of CLECs as a group had fallen by 65.8% since January 1, 2001.³¹ By July
7 22 of this year, the cumulative decrease in CLEC values since November 2001 had escalated
8 to 40%.³² As *The Economist* recently observed:

9
10 The telecoms bust is some ten times bigger than the better known dotcom crash:
11 the rise and fall of telecoms may indeed qualify as the largest bubble in history.
12 Telecoms firms have run up total debts of around \$1 trillion. And as if this
13 were not enough, the industry has also disgraced itself by using fraudulent
14 accounting tricks in an attempt to conceal the scale of the disaster.³³
15

16 *The Economist* goes on to note that “[t]he likely winners, it is already clear, are the former
17 “Baby Bells” in America and the former monopoly incumbents in Europe.”³⁴ The cratering
18 of CLEC share prices indicate that (1) investors have less confidence in these companies’

19 31. Morgan Stanley Dean Witter, Equity Research: North America, Industry: Competitive
20 Local Exchange Carriers (CLECs), August 14, 2001, at 1, provided in Attachment 10. In an
21 earlier report issued by MSDW, its analysts indicated that “[u]nlike the last two CLEC market
22 corrections, we do not believe that the current one is likely to end with the entire group
23 rocketing back because, over the next six months, we expect news headlines to be peppered
24 with reports of additional bankruptcies.” Morgan Stanley Dean Witter, Equity Research:
25 North America, Industry: Competitive Local Exchange Carriers (CLECs), November 7, 2000,
26 at 2.

27 32. “Telecoms Adrift In Market Turmoil; TR Daily Telecom Index Plunges 4.6%”,
28 *Telecommunications Reports Daily*, July 22, 2002.

29 33. “The great telecoms crash,” *The Economist*, July 20, 2000, at 9.

30 34. *Id.*

1 ability to succeed with business plans premised upon competing with ILECs, and (2) the
2 companies themselves now will have much more difficulty attracting capital with which to
3 pursue any future business plans. A facilities-based CLEC requires a substantial amount of
4 up-front investment, and a lack of capital with which to pursue market entry will effectively
5 block most such efforts. CLECs — particularly those still in business today — also require
6 recurring infusions of capital to cover losses extant during the initial ramp-up phase of their
7 operations, and the lack of such capital could well force what might otherwise have ultimately
8 been a successful venture into Chapter 11 (as it did for NorthPoint, Covad, Rhythms,
9 HarvardNet, Global Crossing and McLeod, to name a few). In fact, industry officials and
10 financial analysts indicate that they do not expect the capital markets to open up anytime soon
11 for most cash-starved CLECs, which is likely to force more CLECs to sell assets or go into
12 bankruptcy. And those CLECs still in business, that BOCs claim as “competitors,” hardly
13 pose a serious or formidable competitive challenge at a level that would materially work to
14 constrain a BOC’s exercise of market power.

15
16 25. Even with the recent reduction in New York UNE rates, and even considering some
17 of the recent CLEC successes there, Verizon New York retains significant local market power
18 in much of the state. In fact, the area of New York State with the most CLEC activity, as
19 measured by the percentage of total lines served by CLECs, is Rochester — an area *not even*
20 *being served by Verizon New York*. In addition, the Poughkeepsie LATA, at year end 2000,
21 showed only a 5% CLEC penetration rate.³⁵ While the statewide CLEC penetration rate in
22 New York hovers in the low 20% range, New York State continues to have areas with little

23 35. New York Public Service Commission, *Analysis of Local Exchange Service*
24 *Competition In New York*, Data as of December 31, 2000 (Available at:
25 <http://dps.state.ny.us/telecom/telanalysis.htm>).

1 or no CLEC presence.³⁶ Where Verizon New York is the ILEC in these regions, the BOC
2 not only retains market power, it in fact remains a monopoly. Until conditions across the
3 state indicate that Verizon New York has lost its local market power, removing the Section
4 272 safeguards would disproportionately impact those consumers in areas with little or no
5 competition.

6
7 26. Over the next year and a half, four states — New York, Texas, Kansas and
8 Oklahoma — will reach the three-year sunset point. According to the FCC's most recent
9 *Local Competition Report*,³⁷ CLECs in Kansas serve only 9% of the local market, while the
10 CLEC share in Oklahoma is an even more dismal 8% (below the national average). This
11 figure is likely to be even smaller now, since Global Crossing, a CLEC that was active in
12 both Kansas and Oklahoma, has filed for bankruptcy since the December 2001 time frame of
13 the data in the *Local Competition Report*.

14
15 27. Kansas and Oklahoma, the third and fourth states to receive Section 271 authority,
16 have seen nowhere near the amount of competitive local growth that the BOCs attempt to
17 ascribe to "271" states. More generally, a statistical examination of CLEC retail and
18 facilities-based penetration rates as between states with and without ILEC in-region long
19 distance authority finds no statistically significant link between in-region authority and CLEC
20 penetration (see Attachment 2).

21
22 28. This uneven distribution of local competition in the states first receiving Section 271
23 authority belies any claim that the competitive local entry "spurred" by BOC long distance

24 36. *Local Competition Report*, at Table 14.

25 37. *Id.*, at Table 6.

1 entry has eliminated BOC *local* market power. There are several even more compelling
2 examples that confirm this conclusion. At the time of the break-up of the former Bell
3 System, two of the “Bell System” companies — The Southern New England Telephone
4 Company (“SNET”) in Connecticut and Cincinnati Bell, Inc. in Ohio and Kentucky — were
5 only minority-owned by AT&T and were not required to be divested or made subject to the
6 interLATA long distance line-of-business restriction that applied to all of the other Bell
7 Operating Companies. AT&T voluntarily divested its remaining interest in both of these
8 companies shortly after the break-up, and both were free to enter the long distance market at
9 any time from 1984 onward. The GTE operating companies were not subject to the Bell MFJ
10 line-of-business restriction, but became subject to a similar prohibition against long distance
11 entry when GTE acquired a controlling interest in Sprint. However, the 1996 *Telecommuni-*
12 *cations Act* lifted the GTE long distance ban,³⁸ and the GTE companies were free to — and
13 did — enter the long distance market as of the date of enactment, i.e., February 8, 1996.
14 SNET, in fact, entered the Connecticut long distance market in 1993,³⁹ some *seven years*
15 *sooner* than Verizon and SBC began offering such services in New York and Texas, respec-
16 tively. Following enactment of the 1996 law and adoption of implementation rules by the
17 FCC later than year, SNET and the GTE companies, all of which are ILECs as defined at 47
18 U.S.C. §251(h), were required to comply with the unbundling, resale, interconnection, and
19 nondiscriminatory access to poles, ducts, conduit, operator services, directory assistance,
20 directory listings as well as other the requirements of Sections 251 and 252 that I have
21 previously enumerated (see Table 1 above). These obligations are very similar to the market
22 opening requirements of Section 271(c)(2)(B), and when complied with by the ILECs *as they*

23 38. 47 U.S.C. § 601(a)(2).

24 39. SBC Investor Briefing, *SBC Enters \$7.7 Billion Texas Long-Distance Market*, July 10,
25 2000.

1 *are required to do* would afford competitors the same ability to enter the local market in the
2 *non-BOC* ILEC service areas as would prevail in BOC jurisdictions once the “competitive
3 checklist” had been satisfied.
4

5 29. SNET is the dominant ILEC in Connecticut, and GTE (now Verizon) is the *sole*
6 ILEC in Hawaii. If in fact there were any kind of *causal link* between ILEC long distance
7 entry and the “stimulation” of local competition, one would expect to see rampant CLEC
8 activity and market penetration in both of these states, as well as in such concentrated GTE
9 (now Verizon) local service areas as southern California and the west coast of Florida. The
10 facts speak otherwise. Studies by the FCC and others confirm that despite these ILECs' *early*
11 long distance entry, very little competitive *local* entry has occurred. The CLEC share in
12 Connecticut is only about 7%, and CLEC activity is virtually nonexistent in Hawaii.⁴⁰
13

14 30. BOC retention of market power in the local market is also illustrated by the fact
15 that, even in the place where CLECs are the most active — New York City — the incumbent
16 BOC (Verizon) has failed to adjust its prices in response to competitor pricing initiatives. For
17 example, Verizon New York provides basic residential service on a message-rate basis in
18 most of New York City, with an untimed charge per local call of 10.6 cents. CLECs have
19 introduced various new pricing regimes in an effort to differentiate their services from those
20 of Verizon, including unlimited local calling and pricing plans that include thousands of local
21 minutes.⁴¹ However, even with CLEC penetration of the New York City residential market

22 40. *Local Competition Report*, at Table 6. Connecticut had just 8% CLEC end-user
23 switched access lines; Hawaii's CLEC share was so small that it was not even included in the
24 FCC report, with the explanation, “data withheld to maintain confidentiality.”

25 41. According to AT&T's website, AT&T offers a package of unlimited local minutes and
26 (continued...)

1 now exceeding 20%, Verizon New York has maintained “measured-only” pricing for basic
2 service,⁴² although the Company is apparently in the process of introducing a new “package”
3 of residential basic service and vertical features, targeted to high-end customers in New York,
4 that includes flat-rate local and intraLATA toll calling for \$54.95 per month.⁴³ And in
5 February of this year, Verizon received authority from the New York PSC to *increase* its
6 basic residential rates throughout New York State.⁴⁴ Verizon’s revealed conduct confirms
7 that it has “the ability to raise and maintain price above the competitive level without driving
8 away so many customers as to make the increase unprofitable.”

9
10 31. Finally, the extraordinary difficulties that CLECs confront when attempting to
11 compete with a BOC or other ILEC is compelling demonstrated by the fact that the two
12 largest BOCs — Verizon and SBC — have themselves failed to actively pursue out-of-region
13 local market entry (as CLECs) *even after having represented to the FCC that they would do*
14 *so*. SBC, in its Joint Application for approval of its merger with Ameritech,⁴⁵ and Verizon,

15 41. (...continued)
16 three vertical features in Manhattan for \$23.90 per month. Talk America offers 5,000 local
17 minutes, unlimited vertical features and long distance benefits to customers in Manhattan for
18 \$35.95 a month.

19 42. Verizon New York PSC Tariff No. 2, Second Revised page 22, eff. May 13, 2002.

20 43. Verizon NY PSC Tariff No. 1, Section 2, Original page 220, Original page 57, eff.
21 July 26, 2002.

22 44. Verizon Press Release, “New York PSC Approves Verizon Regulatory Plan; Company
23 Announces First Basic Rate Increase in 11 Years; Continues Commitment to Service Quality,”
24 February 27, 2002.

25 45. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc.,*
26 *Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and*
27 (continued...)

1 in its Joint Application for approval of its merger with GTE,⁴⁶ each represented that
2 following their respective mergers the two mega-ILECs would each commit to pursuing “out-
3 of-region” entry in various local exchange service markets. SBC had identified thirty such
4 markets (of which 17 were in what would become Verizon territory),⁴⁷ while BA/GTE
5 (Verizon) committed to enter twenty-one markets.⁴⁸ Although various parties and their
6 experts, including myself, were highly skeptical as to the legitimacy of these so-called
7 “commitments,” both sets of joint applicants insisted that their respective “national local
8 strategies” would be aggressively pursued and would result in a significant enhancement of
9 facilities-based local competition throughout the country.⁴⁹ In its Orders approving the two
10 mergers, the FCC undertook to put some teeth into what were in other respects “soft”
11 commitments on the part of the two sets of merger parties with respect to their out-of-region
12 local entry plans. In its *SBC/Ameritech Order*, the Commission *required* SBC to undertake
13 the promised out-of-region local entry, and indicated that the post-merger SBC would be fined

14 45. (...continued)
15 *Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24,*
16 *25, 63, 90, 95, and 101 of the Board's Rules*, Before the Federal Communications
17 Commission, CC Docket No. 98-141, *Application*, Filed July 27, 1998 (“SBC/Ameritech
18 Merger Application”), at Sec. II.A.1.

19 46. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the*
20 *Transaction, Public Interest Showing and Related Demonstrations*, Before the Federal
21 Communications Commission, CC Docket No. 98-184, *Application*, Declaration of Jeffrey C.
22 Kissell, Filed October 2, 1998, (“*Bell Atlantic/GTE Merger Application*”), at para. 14.

23 47. *SBC/Ameritech Merger Application*, Attachment A: “New Markets for the New SBC”

24 48. *Bell Atlantic/GTE Merger Application*, at para. 14.

25 49. *Id.*, at para. 15; *SBC/Ameritech Application*, Affidavit of James S. Kahan, at para. 27.

1 as much as \$39.6-million for each of the 30 out-of-region markets that it did not enter.⁵⁰ In
2 the *BA/GTE Order*, the FCC similarly imposed the threat of fines if BA/GTE failed to invest
3 at least \$500-million in out-of-region CLEC activities, or provide service as a CLEC to at
4 least 250,000 customer lines, by the end of 36 months following the merger closing date.⁵¹
5 As it has turned out, of course, the skepticism of various commenters and the concerns of the
6 FCC with respect to the veracity of these out-of-region local entry "commitments" were well-
7 founded. Early last year, both SBC and Verizon announced that they had each abandoned or
8 drastically scaled-back their out-of-region local entry plans.⁵² The decision by both SBC

9 50. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc.,*
10 *Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and*
11 *Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24,*
12 *25, 63, 90, 95, and 101 of the Board's Rules*, CC Docket No. 98-141, *Memorandum Opinion*
13 *and Order*, October 6, 1999, at Appendix C, para. 59(d). The FCC ordered:

14
15 If an SBC/Ameritech Out-of-Territory Entity fails to satisfy any of the 36 separate
16 requirements for each out-of-territory market on or before the deadlines set forth in
17 Subparagraph c, SBC/Ameritech shall make a one-time contribution of \$1.1 million
18 for each missed requirement (up to a total contribution of \$39.6 million per market
19 and \$1.188 billion if SBC/Ameritech Out-of-Territory Entities fail to satisfy all 36
20 requirements in all 30 markets) to a fund to provide telecommunications services to
21 underserved areas, groups, or persons.

22 51. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the*
23 *Transaction, Public Interest Showing and Related Demonstrations*, CC Docket No. 98-184,
24 *Memorandum Opinion and Order*, Rel. June 16, 2000, at paras. 43-48.

25 52. Rory J. O'Connor, "Looser Reins," *eWeek*, March 26, 2001; "SBC Says It Meets
26 Merger Terms Despite Out-Of-Region Cutbacks," *TR Daily*, March 20, 2001. In an obvious
27 effort to escape the heavy fines that would otherwise apply, on March 5, 2002, SBC repre-
28 sented to the FCC that it is in compliance with its out-of-region entry commitments "for 16 of
29 the required 30 markets," averring that "SBC Telecom, Inc. ("SBCT"), the SBC business unit
30 with this responsibility, ... is offering local exchange service to all business customers and all
31 residential customers throughout the areas in the market that are either (a) within the local
32 (continued...)

1 and Verizon to refrain from active pursuit of an out-of-region CLEC entry strategy suggests
2 either that (a) both companies have concluded that such ventures will not be profitable due to
3 the substantial economic barriers and other hurdles that they would each have to overcome, or
4 (b) the two companies have tacitly adopted a market allocation "agreement" in which each
5 firm stays out of the other's territory. The first explanation clearly indicates the presence of
6 substantial market power on the part of the incumbent LEC, while the second explanation
7 would only be sustainable if entry by other CLECs is not a serious threat.

8
9 **With market power in the *local* market, a BOC has the ability to extend its local**
10 **monopoly into the long distance market, unless constrained by regulation.**
11

12 32. As mentioned earlier, the MFJ prohibited the divested BOCs from offering
13 interLATA long distance services. This *structural remedy* was adopted in order to prevent
14 the BOC local service monopolies from using their monopoly market power in the local
15 services market to block competition in the adjacent long distance market. The specific
16 focus, at that time, was on the matter of *access* by competing long distance carriers to

17 52. (...continued)
18 service area of the incumbent RBOC located within the PMSA of the market or (b) within the
19 incumbent service area of a Tier I incumbent LEC (other than SBC/Ameritech) serving at
20 least 10 percent of the access lines in the PMSA ..." Letter dated March 5, 2002 to William
21 F. Caton, Acting Secretary, FCC, from Carlyn D. Moir, Vice President, Federal Regulation,
22 SBC Communications, Inc. SBC's representations to the Commission notwithstanding, the
23 SBC Communications, Inc. website expressly indicates that service is available only in the
24 thirteen in-region (i.e., SWBT, Pacific Bell, Ameritech and SNET) states (see Attachment 3).
25 Moreover, the SBC Communications, Inc. website, www.sbc.com, states that "SBC Communi-
26 cations, Inc. serves 20 of the largest U. S. markets," a figure that clearly does not include the
27 out-of-region markets purportedly being served by SBC Telecom, the SBC out-of-region
28 CLEC business unit. Significantly, the SBC website does not even mention or provide a link
29 to SBC Telecom; the only means by which a consumer would know about SBC's out-of-
30 region local service offerings is by tracking down "SBC Telecom" specifically. Clearly, this
31 "out-of-region" CLEC activity is barely on SBC's radar screen.